



State of California

Board of Equalization
Legal Division

Memorandum

To :

Date: August 23, 1995

From : Kristine Cazadd

K. Cazadd

Subject: Change in Ownership - Partnership Transfers, Section 64 (d).

This is in response to your memorandum of June 20, 1995, in which you request our opinion concerning the change in ownership consequences of the following plan involving a merger and acquisition of several partnerships and corporations, all of which own California real property. The transaction is described in an attachment to questions 7 and 8 on the "Statement of Change in Control and Ownership of Legal Entities" filed by United Packaging Company in 1994. The chronological series of steps are set forth therein substantially as follows:

Step 1. Division into UPCO.

Division Warehouse Co. ("Division") is a California general partnership owned equally (25% each) by four individuals, Robert, James, David, and Joseph and their spouses. On December 18, 1992, Division merged into another California general partnership, United Packaging Co. ("UPCO"). UPCO was owned by the same four partners (and their spouses) in the same percentages as they owned Division (25% each).

Step 2. UPCO Acquisition of Fairbanks and Midcal Properties.

On the same date, December 18, 1992, UPCO also acquired California real property from two S corporations, Fairbanks Trucking, Inc. ("Fairbanks") and Midcal Aluminum ("Midcal"), which are also equally owned by the same four partners (and their spouses). Fairbanks and Midcal became 6.66% and 25% general partners in UPCO respectively. None of the UPCO partners transferred any of their partnership interests in UPCO to Fairbanks and Midcal, rather, they now owned some of their UPCO interests indirectly through Fairbanks and Midcal.

Step 3. UPCO Acquisition of OLD USIS Assets, Issuance of 37.5% Interests.

On December 30, 1992, UPCO acquired certain assets of a California limited partnership, United States Intermodal Services ("OLD USIS"), which was owned by the children of the four UPCO partners. In exchange for these assets, UPCO issued general

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partnership interests to the Old USIS partners collectively representing 37.5% of UPCO's total capitalization.

The partnership interests of UPCO were simultaneously recapitalized into "preferred limited" and "general" partnership interests so that the preferred and general interests of the original four UPCO partners (and their spouses) represented collectively 62.5% of UPCO's equity.

Step 4. Three UPCO Partners Gift 19.53% Interests to Children.

On December 31, 1992, three of the four original UPCO partners (Robert, David, and Joseph) gifted their UPCO general partnership interests (representing 19.53% of UPCO's total capitalization) to their respective children, but retained their preferred partnership interests.

You suggest that the Step 3 and Step 4 transfers of the general partnership interests represented more than 50% of the original co-owners' interest, resulting in a change in ownership of the real property acquired by UPCO from Division (Step 1) and of the real property acquired by UPCO from Fairbanks and Midcal (Step 2).

LAW AND ANALYSIS

As you are aware, Section 62(a)(2) excludes from change in ownership:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

The statutory provisions of Section 62(a)(2) have been interpreted by Property Tax Rule 462.180, subdivision (b)(2), which also identifies and defines "original co-owners." The rule states in pertinent part:

[Excluded from the change in ownership provisions are] transfers of real property between separate legal entities or by an individual(s) to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership interests in the property remain the same after the transfer. (The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interests, shall be defined as "original

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co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer(s) of the ownership interests in the legal entity.)

With regard to partnerships specifically, Rule 462.180, subdivision (e)(1) states that

Except as provided in (b)(2) [above], when real property is contributed to a partnership or is acquired, by purchase or otherwise, by the partnership, there is a change in ownership of such real property, regardless of whether the title to the property is held in the name of the partnership or in the name of the partner(s), with or without reference to the partnership. Except as provided in (b)(2), the transfer of any interest in real property by a partnership to a partner or any other person or entity constitutes a change in ownership.

Thus, while Section 62, subdivision (a)(2) is one of the primary exclusions from change in ownership for partnerships, certain exceptions to the "rule" that the purchase or transfer of partnership shares is not a change in ownership of the real property of the partnership exist, which are embodied in Section 61, subdivision (h), Section 64, subdivision (c), and Section 64, subdivision (d). Of relevance here is the exception under Section 64, subdivision (d), which states in pertinent part:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the "original co-owners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original co-owners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.

Rule 462.180, subdivision (d)(2) is the pertinent provision which interprets Section 64, subdivision (d) and explains how and when this change in ownership exception must be applied:

When real property transferred to a corporation, partnership or other legal entity is excluded from a change in ownership pursuant to (b)(2) and the "original co-owners" subsequently transfer in one or more transactions, more than 50 percent of the total control or ownership interests in the entity as defined in (d)(1). For purposes of determining whether more than 50 percent of the total control or ownership interests in the entity has been transferred, transfers of

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such interests by the "original co-owners" shall be cumulated beginning with the time of the first ownership interest transfer. (Emphasis added.)

The general rule, apart from the exceptions cited above, is to honor the legal entity per Section 64, subdivision (a), with the result that there is no change in ownership of the real property owned by a legal entity on transfers of interests in that legal entity. Thus, the interests of a corporation, partnership or LLC may be transferred, new shares may be issued or outstanding shares returned, and partners may be added or deleted without triggering reassessment of the real property owned by the entity. Section 64, subdivision (a) states:

Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

Based on the foregoing, we conclude that:

- (1) the real property in the Step 1 merger of Division into UPCO was excluded from change in ownership under Section 62, subdivision (a)(2);
- (2) the Step 2 acquisition by UPCO of real property owned by Fairbanks and Midcal was also excluded from change in ownership under Section 62, subdivision (a)(2);
- (3) the Step 3 acquisition by UPCO of certain assets of Old USIS, in exchange for UPCO's issuance to Old USIS partners of general partnership interests collectively representing 37.5% of its total capitalization is excluded from change in ownership under Section 64, subdivision (a); and
- (4) the Step 4 gift-transfer by three UPCO partners to their respective children of general partnership interests representing 19.53% of UPCO's total capitalization resulted in a change in ownership of UPCO's real property acquired by UPCO from Division (Step 1) and acquired by UPCO from Fairbanks and Midcal (Step 2) under Section 64, subdivision (d).

Step 1 The Step 1 merger of Division into UPCO was excluded from change in ownership under Section 62, subdivision (a)(2), since the same four individuals owned both Division and UPCO in the same proportionate shares before and after the merger. The merger resulted solely in a change in the method holding title to Division's property and the individual

¹ See, however, Step 2 analysis for possible alternative conclusion, pages 4 and 5.

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partners' proportional ownership interests in the property remained the same. However, the acquiring partners in UPCO were at that point defined as "original co-owners" for purposes of determining whether a change in ownership would occur upon the subsequent transfer(s) of the partnership interests in UPCO.

Step 2 The Section 62, subdivision (a)(2) exclusion is also applicable to the Step 2 acquisition by UPCO of real property owned by the two "S" Corporations, Fairbanks and Midcal, since the facts indicate that the UPCO partners owned such property in the same proportionate shares both before the acquisition, as Fairbanks and Midcal shareholders, and after the acquisition as UPCO partners, even though some of their UPCO partnership interests were at this point owned indirectly through Fairbanks and Midcal.

Another issue relevant to our analysis here is whether the partnership interests transferred to Fairbanks and Midcal in Step 2 should be counted for purposes of Section 64, subdivision (d) in determining whether cumulatively more than 50% of the total interests in UPCO are transferred subsequent to the acquisition of real property by UPCO from Division (Step 1). Neither the statutes, the property tax rules, nor case law provide definitive guidance on this question.

In the past, we have not advocated counting partnership interests transferred in connection with excluded Section 62, subdivision (a)(2) transfers, because the transfers have been excluded by statute and by rule and there is no express legislative intent to do so. Certainly an argument could be made, however, that such partnership interests transferred should be counted, since there are no statutory or regulatory provisions which define or limit the term "transferred" as it is used in Section 64, subdivision (d). If the term "transferred" is applied literally and given its broadest scope, then every transfer of any ownership interest in a legal entity, including every transfer of every partnership interest in a partnership, would be counted for purposes of Section 64, subdivision (d). Until the language is clarified either through legislation, regulation or court construction, we must advise that it is possible for assessors to give the term "transferred" its broad, literal meaning. If that were to occur here, then the Step 2 transfer from UPCO to Fairbanks and Midcal of 6.66% and 25% general partnership interests respectively would count toward the cumulative 50% of the total partnership interests transferred subsequent to the acquisition of real property by UPCO from Division (Step 1), resulting in a change in ownership of the real property acquired by UPCO from Division under Section 64, subdivision (d) in Step 3 rather than Step 4.

Step 3 Assuming, for the sake of this analysis, that the assessor does not count the partnership interests transferred in Step 2 for purposes of Section 64, subdivision (d), when UPCO acquired certain assets of OLD USIS, in exchange for the transfer of general partnership interests representing 37.5% of UPCO's total capitalization to the Old USIS partners

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(who were not the same individuals as UPCO partners), the collective interests of the four UPCO partners (and their spouses) was reduced to 62.5% of UPCO's equity. Since the UPCO partnership interests transferred to the OLD USIS partners constituted ownership interests of less than 50%, the provision of Section 64, subdivision (d) would not trigger a change in ownership of the real property acquired by UPCO from Division (Step 1) or of the real property acquired by UPCO from Fairbanks and Midcal (Step 2).

Step 4 However, the transfer of UPCO general partnership interests representing 19.53% of UPCO's total capitalization to three of the four UPCO partners' children does trigger the application of Section 64, subdivision (d), since the transfers by the "original co-owners" per Rule 462.180, subdivision (d)(2), when cumulated with the transfer of UPCO general partnership interests to the Old USIS partners, (37.5% plus 19.53%) are more than 50% of the total partnership interests transferred. As the UPCO partners were "original co-owners" and transferred cumulatively ownership interests of more than 50% at the time of the Step 4 transfer, the real property acquired by UPCO from Division (Step 1) and the real property acquired by UPCO from Fairbanks and Midcal (Step 2) which was previously excluded from change in ownership by Section 62(a)(2), was removed from the benefits of the exclusion and must undergo property tax reassessment.

The taxpayer has asserted, for purposes of applying Section 64, subdivision (d), that the "original co-owner(s)" was not the partnership entity, UPCO, but the original UPCO partners. The position of the taxpayer is that since the transferor of the partnership interests in Steps 3 and 4 was UPCO and not the individual partners who are the "original co-owners," there were no transfers of partnership interests by the "original co-owners" to trigger the application of Section 64, subdivision (d). This argument is stated by the taxpayer on page 3 of its January 10, 1994 Letter Attachment to questions 7 & 8, to the effect that no transfers of UPCO partnership interests were made by the "original co-owners;" rather "It was UPCO, not its original co-owners, which issued new partnership interests."

In our view this argument is without merit and conflicts with the entire statutory scheme of Section 64, subdivision (d). "Original co-owners," per Section 64, subdivision (d) are former transferors of property to the entity that avoided prior reassessment because their proportional ownership interests in the entity remained identical to their previous ownership interests in the real property transferred. (See definition of "original co-owners" in Rule 462.180, subdivision (b)(2).) The intent then, is to track ownership interests in a partnership transferred. It is immaterial whether the source of subsequent transfers of ownership interests in a partnership is the partnership entity or the partners themselves, since it is partnership ownership interests which are tracked. Thus, the language of Section 64, subdivision (d) has been interpreted as referring to transfers exceeding 50% of the total interests in the entity, i.e., more than 50% of the total interests in the entity initially acquired

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by the group of original transferors, because it is only shifts in the interests of this group of owners in that entity which are relevant. (See SBE Special Topics Survey: Assessments Practices, p.15 (August 1984).)

This is consistent with the language in Rule 462.180, subdivision (b)(2), wherein the ownership interests to be tracked are expressly stated to be "more than 50% of the total control or ownership interests in the entity as defined in (d)(1)." (Subdivision (d)(1) defines ownership interests in a partnership as "direct or indirect ownership or control of more than 50 percent of the total interest in both partnership capital and profits.") In this case, the four partners are original co-owners, which means that 100% of the ownership interests in UPCO previously received the benefit of the Section 62, subdivision (a)(2) exclusion from change in ownership. Therefore, if more than 50% of the total capital and profits interests in UPCO is subsequently transferred in one or more transactions, the property or properties previously excluded will be considered to have changed ownership and will be reassessed. Whether UPCO as an entity transfers such the capital and profits interests or the UPCO partners make the transfers, in tax cases, it is the "substance of the transaction, rather than the form" that will determine if a change in ownership has actually occurred. (Shuwa Investment Corp. v. County of Los Angeles (1991) 1 Cal. App. 4th 1635).

We note also that the purpose of the "original co-owners'" exception in Section 64, subdivision (d) was to prevent evasion from change in ownership and reassessment through the use of legal entities and to maintain relative property tax parity between residential properties and business properties. Thus, the Legislature allowed ownership interests in real property to be transferred from individuals or legal entities to a legal entity and vice versa in the same proportionate shares with an exclusion from change in ownership under Section 62, subdivision (a)(2). However, the Legislature wanted to head off two-step transfers of property from one person to another person through a legal entity which would otherwise escape reappraisal, (e.g., "A" forms a corporation, transfers his home to the legal entity, sells his shares in the entity to "B", then "B" dissolves the legal entity). (See Report of Legislative Task Force on Property Tax Administration, Assembly Revenue and Taxation Committee, January 22, 1979, p.414.) As the court stated in Sav-on Drugs, Inc. v. Orange County, 190 Cal.App.3d 1611, 1624-1625 (1987),

"If the Legislature had not clarified the phrase 'change of ownership' as it did, corporations might have enjoyed an unjustifiable and unintended advantage over individuals in the buying and selling of real estate. Plaintiffs' real complaint is that they have not received special treatment. They have only been treated equally and must, like individuals who acquire control of real estate, undergo a reassessment....".



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DOUGLAS D. BELL
Executive Secretary

June 4, 1986

Dear

This is in response to your letter of May 12, 1986 to
in which you ask our opinion about the
application of the "step transaction doctrine" in the following
situation:

"A husband and wife who own an apartment building propose to transfer the apartment building to a limited partnership in which they will each own a 50% interest. Subsequently, either by gift or sale, they propose to issue partnership interests to their six children. The purposes for setting up the partnership and issuing partnership interests, rather than co-ownership interests to the children are to provide income to the children which would not be taxable to the parents, to transfer property to the children gradually rather than entirely at the death of the parents, and to limit the liability of the children which might arise from direct ownership of the property."

You have stated that under Revenue and Taxation Code sections 62(a)(2), 64(a) and 64(d), there would be no change in ownership upon the original transfer by the parents to the partnership or upon successive transfers of up to 50 percent of the ownership interests in the partnership to the children. In your opinion, the "step transaction doctrine" is inapplicable here because there is a valid business purpose for transferring the property to a partnership owned by the parents before transferring the partnership interests to their children.

Section 60 of the Revenue and Taxation Code (all section references contained herein are to the Revenue and Taxation Code) states that:

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A "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which substantially equal to the value of the fee interest.

Included in the definition of change in ownership by section 61(1) is:

The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

However, section 62(a)(2) excludes from a change in ownership:

Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer. The provisions of this paragraph shall not apply to transfers also excluded from change in ownership under the provisions of subdivision (b) of Section 64.

Section 64 (a) deals with the transfer of ownership interests, such as interests in partnerships and states:

Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

Section 64(c) provides that:

When a corporation, partnership, other legal entity or any other person obtains control, as defined in Section 25105, in any corporation, or obtains a majority ownership interest in any partnership or other legal entity through the purchase or transfer of corporate stock, partnership interest, or ownership interests in other legal entities, such purchase or

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transfer of such stock or other interests shall be a change of ownership of property owned by the corporation, partnership, or other legal entity in which the controlling interest is obtained.

Section 64(d), in pertinent part, states that:

If property is transferred on or after March 1, 1975, to a legal entity in a transaction excluded from change in ownership by paragraph (2) of subdivision (a) of Section 62, then the persons holding ownership interests in such legal entity immediately after the transfer shall be considered the "original coowners." Whenever shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the entity are transferred by any of the original coowners in one or more transactions, a change in ownership of that real property owned by the legal entity shall have occurred, and the property which was previously excluded from change in ownership under the provisions of paragraph (2) of subdivision (a) of Section 62 shall be reappraised.

These statutory provisions are interpreted by subdivision (j) of property tax Rule 462, which states, in pertinent part:

(1) Transfers of property to and by legal entities. Except as is otherwise provided in subdivision (2), the transfer of any interest in real property to a corporation, partnership, or other legal entity is a change in ownership of such real property transferred.

(2) Exclusions

* * *

(B) Transfers of real property between separate legal entities or by an individual(s) to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership interests in the property remain the same after the transfer. (The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership shares, or other types of ownership interests, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer(s) of the ownership interests in the legal entity.)

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(3) Transfers of ownership interests in legal entities. Except as is otherwise provided in subdivision (4), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity.

(4) Exceptions:

(A) When any corporation, partnership, other legal entity or any person:

* * *

(11) obtains direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits.

* * *

(B) When real property transferred to a corporation, partnership or other legal entity is excluded from a change in ownership pursuant to (2)(B) and the "original co-owners" subsequently transfer in one or more transactions more than 50 percent of the total control or ownership interests in the entity as defined in (4)(A). For purposes of determining whether more than 50 percent of the total control or ownership interests in the entity has been transferred, transfers of such interests by the "original co-owners" shall be cumulated beginning with the time of the first ownership interest transfer.

Assuming that Husband and Wife originally held equal ownership interests in the apartment building, the transfer from Husband and Wife to a partnership in which Husband and Wife each took back a 50 percent interest could be excluded from a change in ownership under section 62(a)(2) because proportional ownership interests in the property will be maintained after the transfer. Furthermore, subsequent transfers of ownership interests in the partnership to the couple's children would not constitute a change in ownership under section 64(a) and Rule 462(j)(3).

However, section 64(c) and its accompanying Rule 462(j)(4) indicate that a change in ownership will occur if more than a 50 percent interest in partnership profits or capital is

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acquired by any person or entity. Thus, the acquisition by one of the children of such an interest would constitute a change in control and therefore a change in ownership of the partnership. Moreover, since the transfer to the partnership was excluded from change in ownership by section 62(a)(2), a change in ownership would also occur under section 64(d) and Rule 462(j)(4)(B) if more than 50 percent of the interests in the partnership were subsequently transferred.

You have asked for our opinion about the application of the "step transaction doctrine" in these factual circumstances. The "step transaction doctrine," a federal income tax doctrine which has been applied to property tax transfers, asserts that the substance of a transaction rather than the form should determine the tax consequences (Commissioner of Int. Rev. v. Court Holding Co. (1945) 324 U.S. 331, 334). Unnecessary steps which are taken merely to circumvent the intent of the change in ownership statutes will be disregarded and the substance of the transaction will determine if a change in ownership has occurred.

This doctrine, of course, is not applicable unless unnecessary steps to avoid a change in ownership have been taken. A determination of whether or not a step is necessary can only be made by examining all of the circumstances, including such factors as business purpose and timing of the steps, surrounding the transactions. In the transaction you have described, the step in question is the transfer from Husband and Wife to a partnership in which they each take back a 50 percent interest. Such a step would not be considered unnecessary if there was a valid business reason for structuring the transaction in this manner. If, for example, Husband and Wife want to shield themselves from liability while they were in the process of transferring the partnership interests to their children, it could be concluded that a valid business reason for transferring the property into a partnership on a proportional basis exists.

It is, of course, the role of the Assessor to ultimately evaluate the facts to determine if he is satisfied with the sufficiency of the evidence in support of a taxpayer's assertion that a valid business reason for a particular transaction exists. Our views are advisory only and are not binding on the assessor of any county. You may therefore wish to consult the Assessor of the appropriate county in order to

June 4, 1986

confirm that the described transfer would be treated in a manner consistent with the conclusion stated above.

Very truly yours,

Barbara G. Elbrecht

Barbara G. Elbrecht
Tax Counsel

BGE:cb

cc:

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Executive Director

May 18, 1989

Dear

This is in response to your request that we advise of possible change in ownership consequences under the following circumstances:

ABC Partnership, which owns real property, has as its partners XY Partnership (64% interest), X as an individual (20% interest), and X and Wife as Husband and Wife (community property) or as joint tenants or equal tenants in common (16% interest). Both X and Y have a 50% interest in XY Partnership.

Y dies, XY Partnership is dissolved or otherwise terminates, and X as an individual acquires another 32% interest in ABC Partnership and Y's Estate acquires the other 32% interest therein.

As you are aware, Revenue and Taxation Code section 64(c) states, in part, that when any person obtains a majority ownership interest in any partnership through the purchase or transfer of a partnership interest, such purchase or transfer of such interest shall be a change of ownership of property owned by the partnership. Upon Y's death and dissolution or termination of XY Partnership, X's interest in ABC Partnership totalled 60%, computed as follows:

32% interest obtained from former XY Partnership.

20% interest still held as an individual.

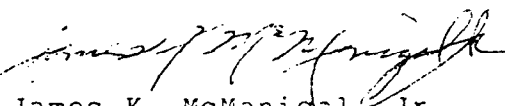
8% interest still held as husband/individual.

May 18, 1989

Thus, since X obtained a majority ownership interest in ABC Partnership through the transfer of a partnership interest from the former XY Partnership, such transfer resulted in a change of control under section 64(c) and a change in ownership of the property owned by ABC Partnership.

It might be contended that X had control, direct and indirect, of ABC Partnership prior to Y's death by virtue of his 32% interest in XY Partnership (indirect), his 20% interest (direct) and his 8% interest (also direct), such that no change in control occurred as the result of Y's death. It has been our interpretation of the change in ownership statutes and rules, however, that for one who is a partner in a partnership, shareholder in a corporation, etc., to be considered to be in control of the entity, such that indirect ownership/control of the entity can be attributed to him or her for change in ownership purposes, that person must have more than a 50% interest in the partnership, corporation, etc. Thus, had X had a 50.01% or more interest in XY Partnership such that he had control thereof, he would have been regarded as having indirect control of 64% of ABC Partnership from the inception, and Y's death would not have resulted in a change in control or change in ownership. As X only had a 50% interest in XY Partnership, however, such was not the case and indirect control of XY Partnership could not be attributed to him for change in ownership purposes. See in this regard Mr. Eric Eisenlauer's May 3, 1989, memorandum to Mr. Verne Walton, copy enclosed.

Very truly yours,


James K. McManigal, Jr.
Tax Counsel

JKM:wak
2420H

Enclosure

cc:



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Controller, Sacramento

August 26, 1992

BURTON W. OLIVER
Executive Director

Re: Advisory Opinion Regarding Change in Ownership-
Transfer of Partnership and Real Property Interests -
Parent/Child Exclusion.

Dear

This is in response to your letter of June 17, 1992, in which you requested our opinion as to whether there is a change in ownership as a result of the following circumstances described in your letter:

1. In 1968 a revocable living trust was created by Husband and Wife. "Husband" died in 1971, at which time the trust assets were divided between the husband's portion ("Trust") and the Wife's portion. The Trust assets consisted of:

- a 25 percent partnership interest in Partnership 1;
- a 33 percent partnership interest in Partnership 2;
- a 25 percent ownership interest in real property.

2. On Husband's death, Wife and children were entitled to the net income of the Trust. Upon Wife's death recently, Trust is being terminated, and all assets are to go to children in equal shares as the remainder beneficiaries of the Trust.

The question is whether the transfer of the partnership and property interests to the beneficiaries will constitute a change of ownership for property tax reassessment purposes.

LAW AND ANALYSIS

Rev. & Tax. Code Section 60 defines "change in ownership" as a "transfer of a present interest in real property, including the

August 26, 1992

beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

However, if the transfer involves ownership interests in a partnership or other legal entity, then the general rule of Section 64(a) applies. Section 64(a) provides the following exclusion from a change in ownership:

Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership interests, shall not be deemed to constitute a transfer of the real property of the legal entity.

Of relevance here is the exception under Section 64(c) which states in pertinent part:

When a corporation, partnership, or other legal entity or any other person obtains control, as defined in Section 25105, in any corporation, or obtains a majority interest in any partnership or other legal entity through the purchase or transfer of corporate stock, partnership interest, or ownership interests in other legal entities, such purchase or transfer of such stock or other interest shall be a change of ownership of property owned by the corporation, partnership, or other legal entity in which the controlling interest is obtained.

These statutory provisions are interpreted by Property Tax Rule 462 (j), which provides in part:

(3) Transfers of ownership interests in legal entities. Except as otherwise provided in subdivision (4), the purchase or transfer of corporate stock, partnership shares, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity.

(4) Exceptions:

(A) When any corporation, partnership, other legal entity or any person:

(ii) obtains direct or indirect ownership of more than 50 percent of the total interest in both partnership capital and profits,

Upon the acquisition of such direct or indirect ownership or control, all of the property owned directly or

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indirectly by the acquired legal entity is deemed to have undergone a change in ownership.

Based on the foregoing, it is clear that the transfer of the partnership interests will not trigger a change in ownership, unless the transfer of an interest or interests results in more than 50 percent of the total interest in one or both of the partnerships' capital and profits being acquired by one or more of the children.

Since under the assumed facts, the children will receive partnership interests of less than 25 percent and 35 percent, respectively, the transfers of those interests, of themselves, will not constitute a change in ownership of the partnerships' properties. And assuming that the transfers will not result in any child gaining an interest of more than 50 percent in either partnership's capital and profits, the transfers described above will not constitute a change in ownership of either partnership's property. However, if there is a subsequent transfer, whereby any child obtains a cumulative interest in a partnership's capital and profits in excess of 50 percent, a change in ownership requiring reassessment of the all property owned by the partnership involved would occur.

With regard to the transfer of the Trust's 25 percent interest in the real property to the children, Section 63.1(a) provides that a change in ownership shall not include,

(2) The purchase or transfer of the first \$1,000,000 of full cash value of all other real property of an eligible transferor in the case of a purchase or transfer between parents and their children.

"Transfer" includes and is not limited to, any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos or testamentary trust. Section 63.1(f), however, limits the application of these provisions to purchases and transfers of real property completed on or after November 6, 1986.

Under the foregoing provisions, it is clear that a \$1,000,000 exclusion is available with respect to real property owned by an eligible transferor in trust and transferred to his children. In our view, the Husband was an eligible transferor since, when he died in 1971, the beneficial interest in the Trust real property passed from him to his Wife for life and to his

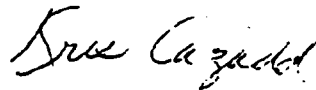
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children as equitable remaindermen. Wife received only a life estate with no remainder interests in the Trust property. Those remainder interests were owned by the children until Wife died. Upon her death, on or after November 6, 1986, their remainder interests became possessory (i.e., they became present beneficial interests), and a change in ownership occurred at that time by operation of law. The rationale for this conclusion is that it was the interest in real property of the Husband and not the Wife which the children received when the Trust terminated.

The views expressed in this letter are, of course, advisory only and are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in order to confirm that the described properties will be assessed in a manner consistent with the conclusions stated herein.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this objective are appreciated.

Very truly yours,



Kristine Cazadd
Tax Counsel

cc:

prrshp.par

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The transactions here are similar to the type of two-step transfers which the Legislature intended to characterize as changes in ownership under Section 64, subdivision (d). The UPCO partners, as "original co-owners" who previously benefitted from the Section 62, subdivision (a)(2) exclusion, transferred in the Step 3 and Step 4 transactions general partnership interests in UPCO aggregating more than 50% of UPCO's total capitalization. (The fact that the interests transferred were general partnership interests rather than preferred partnership interests has no bearing on the change in ownership consequences, since the 37.5% and 19.53% each represent that percentage of UPCO's total capitalization.) Once the UPCO interests transferred cumulatively exceeded more than 50% upon the Step 4 transfer, the real property which was previously excluded from change in ownership by Section 62(a)(2) was removed from the benefits of the exclusion and must undergo property tax reassessment.

KEC

220.0538 **Partnership Transfer/Conversion.** A, B, and C, the general partners in a general partnership, admit newly formed Corporation as a general partner by each contributing 1 percent of his partnership interest to Corporation in exchange for proportionate ownership interests in Corporation. As a result, Corporation acquires a 1 percent interest in the partnership, and there is no change in ownership (Revenue and Taxation Code section 64(a)). Thereafter, the partnership converts to a limited partnership and assigns its long-term leasehold interest to the limited partnership. The exclusion from change in ownership pursuant to Revenue and Taxation Code section 62(a)(2) is available, provided that the general partners hold the same proportionate interest in the limited partnership after the conversion; but each general partnership will become an "original coowner" for purposes of determining change in ownership resulting from subsequent transfers of interests in the limited partnership. C 12/6/90. (M99-1)